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ALK.N - Q1 2021 Alaska Air Group Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 adjusted net loss (excluding special items and mark-to-market adjustments) of $436m.

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PRESENTATION

Operator

Good morning. My name is Thea, and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group 2021 First Quarter Earnings Release Conference call. Today's call is being recorded and will be accessible for future playback at alaskaair.com. (Operator Instructions)

Thank you. I would now like to turn the call over to Alaska Air Group's Managing Director of Investor Relations, Emily Halverson. Please go ahead, ma'am.

Emily Halverson - *Alaska Air Group, Inc. - IR*

Thank you, Thea, and good morning. Thanks for joining us for our first quarter 2021 earnings call. This morning, we issued our earnings release, which is available at investor.alaskaair.com.

On today's call, you'll hear updates from Ben in his new role as CEO, and he will be joined by Andrew and Shane for commercial and financial updates. Several others of our management team are also on the line to answer your questions during the Q&A portion of the call.

Our business and outlook continue to be significantly impacted by the global health and economic crises that are underway. In the first quarter, Air Group reported an adjusted net loss, excluding special items and mark-to-market adjustments of $436 million. And we went from burning

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approximately $4 million a day last quarter to cash generation of approximately $1 million a day in March under the same definition. We believe we are among the first in the industry to have achieved this milestone and it marks a critical point in recovery that enables us to turn our attention to the future.

Our comments today will include forward-looking statements about future performance, which may differ materially from our actual results. Information on risk factors that could affect our business can be found in our SEC filings. We will also refer to certain non-GAAP financial measures such as adjusted earnings and unit costs excluding fuel, and as usual, we have provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in today's earnings release.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Thanks, Emily, and good morning, everyone. I appreciate all of you joining us today for an update on our business. As this is my first call as CEO, I thought I'd share some of my thinking on where I will spend my time, energy and focus over the next several years.

Having been with Alaska for 17 years, I have come to know and love what our company is all about. Our people and our culture, our focus on safety and operational excellence, our reputation for customer service and our financial discipline and track record.

Over the years, we have truly embraced a balanced approach to delivering for all stakeholders, and I will continue to nurture this approach and build on that legacy. While we also need to grow and do better in other areas that I look forward to developing: how we manage to reduce our climate impact, ensuring that Alaska is a place where everyone feels they belong and unlocking the power of our brand.

In the short term, however, our primary focus is on rebuilding our business to pre-COVID levels and returning to profitable growth. While Q1 results are far below normal levels, it has marked an inflection point during this pandemic, and it appears that we have turned the corner in several key areas that I will touch on in a moment.

Before I dive into results, I want to welcome Constance von Muehlen into her role as Chief Operating Officer for Alaska Airlines, succeeding Gary Beck. Constance has been with the company for 10 years and is an incredible leader. I know that she will do a fantastic job in this pivotal role.

Onto the quarter recap. As momentum with vaccines has picked up and travel restrictions have eased, there has been a strong return of leisure demand. We have seen passenger enplanements move from being down 65% in January to down 35% in April. Today, sustained future bookings are at roughly 80% of pre-COVID levels. On the strength of these increased bookings and solid cost management against our plan, we posted positive cash flow in March, excluding the impact of the PSP funding. Full quarter operating cash flow, inclusive of funds received under the PSP was positive $167 million.

I'd like to take a moment to thank the employees at Alaska and Horizon for helping us get to this point. They've handled this long downturn with an incredible determination to keep our company moving and ready for a strong return of guests. Protecting the health and safety of our guests and employees, while also protecting the financial health of our business has only been possible because of the collaborative efforts of our employees and labor leadership.

During the quarter, our teams advanced several strategic efforts that are important to shaping our future. First, on March 31st, we celebrated our official entry into oneworld. It was the culmination of a year of work by over 400 people across our company, and I want to specifically thank the IT and e-commerce teams for their incredible efforts to make this possible. Many other teams spent months working on this as well, including our crews and frontline teams who are helping guests navigate the changes we put in place.

Second, we received four 737-9 MAX aircraft and have placed them into operating service. Despite the temporary grounding, which we expect to be resolved in the next week or 2, these aircraft have been very well received by our guests and our crews. By the end of 2022, we will have another 39 MAX 9s, replacing the Airbus A319s and A320s that were retired from service last year. As you know, the MAX has 25% better fuel efficiency, lower maintenance costs and significant revenue opportunity with its higher gauge. The fuel efficiency of the MAX will also help us reduce our

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climate impact through lower emissions. And on that note, we've recently made new sustainability commitments, particularly focused on climate impact and racial equity.

On climate, we announced yesterday our long-term commitment and road map to net-zero carbon emissions by 2040. We also set near-term goals for 2025, focused on being the most fuel-efficient U.S. airline, building on our culture of efficiency in every part of our system and continuing to electrify our GSE fleet.

In February, we announced specific commitments for diversity, equity and inclusion, including the following goals: ensuring the diverse representation of our frontline is reflected in our senior leadership team, cultivating a truly inclusive culture and continuing to support education as a critical element of equity. We know we have not done enough in this area in the last 10 years and that we still have a lot of work ahead of us, but we're committed to making Alaska a place in which everyone feels they belong and can be their best.

And to underscore the importance of climate and DEI commitments, we tied a portion of executive at-risk pay to achieve diversity goals, and our climate-related goals are now part of our performance-based pay program that every employee participates in.

As we look to the remainder of the year and beyond, we are focused on several important areas. First, maintaining balance sheet strength. Our adjusted net debt today is $1.6 billion, down from $1.7 billion at the end of 2019. As we bring capacity and costs back online, we will also prioritize reducing debt levels in the back half of the year. To the extent the recovery is choppy or decelerates, we know having a strong balance sheet will provide foundational strength.

Second, we are focused on returning capacity at a deliberate and responsible rate. As we laid out last year, we will fly 80% of 2019 levels this summer. We plan to return to 100% no later than summer of '22. This trajectory is consistent with our preference to seek higher load factors than we're seeing today and allows us to make progress with pilot transition training to a mostly all-Boeing fleet.

Third, we are developing a road map back to profitability. Our fleet plan and cost restructure program are essential pieces of this road map. Our recent entry into oneworld will be instrumental and we look forward to sharing a framework for the commercial contribution it will bring as we return to our pre-COVID size.

In our forecast today, Q2 is approaching P&L breakeven, and we anticipate turning to profitability in Q3. And it's worth reminding that nearly 50% of our traffic and revenues touched California on a pre-COVID basis, and as you know, California remains largely closed today. Seeing the state reopen will be a powerful near-term enabler for our path back.

As we manage these 3 important aspects of our business, we're cognizant that we may be faced with reasons to modify our plans. Let me state unequivocally that we have the balance sheet, cost structure and cash on hand to adjust our capacity trajectory and will do so if conditions merit. For example, if we saw more robust demand or an acceleration of the business recovery, we will adapt. The same is true if we see competitive threats to our network or future growth.

I know I speak for the whole management team in saying that turning the momentum we're experiencing today into earnings over the long-term is imperative. The work we are focused on and this quarter's results are steps in the right direction. I truly believe Alaska is well-positioned for the future.

And with that, I'll pass it to Andrew who I know you have missed hearing from in the last few quarters.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Thanks, Ben, and good morning, everyone. And it is great to be back speaking with you about the commercial side of our business. Although we've still got a long climb ahead, the momentum that we've seen in the past few months is really exciting as we've started to see demand return.

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First quarter revenues came in at $797 million, down 57.5% from the year over 2. We also saw sequential improvement in each month of the quarter with January revenues down 63%, February down 59% and March down 52%. Passenger enplanements followed a similar trend.

Our first-class cabin performed particularly well, with revenues down 42% for March, which was 10 points better than system average. Low fares resulting in high paid load factors were the main drivers.

Our overall revenue results look to be amongst the strongest in the industry despite, as Ben noted, California demand remaining seriously impaired. To provide perspective on this, the 54% reduction in California bookings during the first quarter versus 2019 were down nearly 2x that of the non-California system average. We expect California to experience a step change in performance by mid-June, which is when the governor has targeted to fully open California's economy.

Capacity was 33% below 2019 levels, which was 3 points worse than we had expected. This was primarily caused by cancellations from a severe winter storm across the Pacific Northwest over President's Day holiday.

For the quarter, our load factor was 52%, which is up 7 points from Q4 on 9 points more capacity, aided by our move to unblocked middle seats beginning in January. This has been really helpful as demand returns. In March, 41% of our mainline departures carried over and above what our load factor caps would have allowed if middle seat blocks had remained in place.

Taking a look at the quarter, load factor accelerated from 42% in January to 49% in February and to 62% in March. Notwithstanding, we added 20,000 more daily seats in March compared to January. This momentum has continued into April, where we expect to get close to a 70% load factor. May is also building at a higher rate than April was at this same time last month.

Turning to bookings. Recent data indicates employment trends should continue to improve. We began the quarter in January with an average of around 60,000 bookings a day or about 43% of 2019 levels. Bookings stepped to approximately 60% of 2019 levels in February and then 75% in March. The sequential improvement in year over 2 year bookings trends has continued into April. With demand and passenger enplanements up as much as we're seeing and the opening of middle seats, I do want to highlight that our Alaska Listens survey for the first quarter continued to show over 80% of guests give us an excellent or very good ratings on health and safety. Additionally, our customer satisfaction scores remained higher than they were pre pandemic. I'd like to personally thank our frontline and crews for making this happen and ensuring our guests feel safe and comfortable even though loads have been increasing, and we no longer block middle seats in the main cabin.

Touching briefly on pricing, yields were 11% below 2019 levels this quarter, in part because of the promotional efforts that we used to stimulate demand for January and February, which are traditionally our weakest months of the year, the pandemic making them especially so. Price volatility is likely an issue we will continue to face in this recovery.

As we look towards summer, we are seeing yields improving with demand. While our bias is towards flying fuller planes, we are clear-eyed about the need to increase yields as we navigate back to our pre-COVID size.

A bright spot during the last year has been our loyalty program. Total mileage plan revenues were down just 32% during the quarter and cash brought in from the bank to compensate us for miles earned on our card surpassed 2019 levels in March. Credit card holders also showed modest growth since the end of 2020, increasing by about 0.5 point. As we see demand return, our teams have started to focus more acutely on the commercial opportunities in front of us. We are picking up from where we left off in 2019, if you will.

Three immediate opportunities for 2021 and beyond have already been put in place. Firstly, tapping into the unique benefits of our American and oneworld alliances. The increased breadth and depth that we can offer guests is next level, creating value from both a network revenue and loyalty revenue perspective. Secondly, implementation of a new RM system, including fare classes that align with our oneworld partners and affords us additional selling classes in the premium cabin. And then thirdly, greater access to managed corporate accounts as we now provide much greater utility with our domestic partnership with American and our global partners with oneworld loyalty benefits. We finally resolved a longtime issue for our corporate guests by now having a seamless global program in place.

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As we look forward, we believe the continuation of the return of demand supports our plans to add back capacity in our strongest hubs in the Pacific Northwest and Alaska, then ultimately, California as it begins to relax restrictions. Business travel remained severely depressed during the quarter, and our quarterly surveys of corporate customers reinforced our belief that business travel will ramp to about 50% of normal levels by the end of this year. That said, we've seen a 4.6 point improvement in our share gap in the year over 2 in the first 2 months of this year for our managed corporate accounts.

Consistent with all I've shared, we remain committed to fly approximately 80% of 2019 levels in the second quarter and total revenues are expected to be down 32% to down 37% versus 2019. For the second quarter, we expect load factor to be between 70% and 75%.

While this pandemic has thrown a litany of challenges our way, I do believe that as vaccines continue to roll out, which has resulted in demand being less and less impacted by guest, case counts, excuse me, we have line of sight to rebuilding our business. Our network, product, fares, loyalty program and commitment to guest service and care are all configured to bring us out of this even stronger than we went in.

And with that, I'll pass it over to Shane.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Thank you, Andrew, and good morning, everyone. Today, I will touch on our cash flows, liquidity and our balance sheet as well as costs and expectations for the second quarter. This quarter felt very much like a turning point away from purely trying to survive and toward rebuilding our business, bringing people and flying back and beginning to chart a path back to profits and growth.

While we reported an adjusted net loss this quarter of $436 million, we were able to generate positive GAAP operating cash flows for the quarter, and positive adjusted cash flows in March, even excluding CARES payroll support grants.

Our air traffic liability increased by $224 million or 21%, reflecting the step-change improvement in demand the industry is currently seeing. Travel credits now represent 37% of our ATL, down from 53% at year-end.

We exited the quarter with an improved adjusted net debt result, which was down from $1.7 billion at the end of 2020 to just under $1.6 billion and our debt-to-cap increased only 1 point to 62%, which we believe will be the high watermark for our debt-to-cap metric and that we will see it reduce from here. We also continue to hold $3.5 billion in on-hand liquidity.

Given booking trends and our balance sheet health, I anticipate that we will begin reducing our cash balance by retiring debt during the second half of the year, ultimately moving towards on-hand liquidity in the range of $2 billion to $2.5 billion.

Having heard from Andrew about the commercial progress we saw in the quarter, let me turn to cost performance. We had several areas of good performance and some we need to drive more improvement in. Adjusted nonfuel operating expenses were $1.14 billion, an increase of $43 million or 3.9% sequentially versus Q4 2020, while capacity increased 8%. As mentioned, for the quarter, we saw strong cost performance in several areas of the business as we beat the cost plan we set out for our divisions. Areas of particular strength included overhead spend, productivity in our airport ramp and aircraft mechanic groups, further progress against long-term structural cost savings and regional flying unit costs, which were nearly flat year over 2, with especially solid cost performance at Horizon.

As we bring back capacity further, we now need to work on improving our crew productivity, which is challenged by recall training, our fleet transition and flying that is not balanced by crew base relative to our pre-COVID schedule.

Speaking of recalls for a second, we were able to welcome 1,500 additional employees back from leave this quarter. We are excited to have our employees back and appreciate what they've done to support the company and their colleagues during the worst and most uncertain periods of the downturn.

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A primary area of cost headwind right now are airport costs as a material share of these costs are not variable with volume. In Q1, airport costs were down just 2.6% on 27% fewer departure volumes, and we continue to see pressure in this area in Q2. Airport leaders were great partnering with the industry last year to manage these costs down and given they have received additional funds under the American Rescue Plan Act, we are anxious to work with them to use these funds to offset costs again in 2021 as they were able to in 2020.

In Seattle specifically, we have a unique $30 million cost headwind versus 2019 related to the sunsetting of a lease provision that previously provided for sharing concession revenues as part of the lease agreement that carriers agreed to in 2018.

I also want to share some additional context on 2 other cost categories: maintenance expense and variable pay expenses. Regarding maintenance, we are not actively deferring maintenance on our operating fleets, and today, we are operating our entire regional and our entire Boeing fleet. Due to this, we won't have a pent-up maintenance backlog going forward. And as such, we expect relatively smooth maintenance costs through the year.

And lastly, more as a reminder than anything, we continue to utilize our long-standing performance-based pay program to align employees on the goals that are key to our short- and long-term success. I believe we may be the only airline right now with continued incentive pay accruals. And in the quarter, we accrued $33.5 million for our monthly operational goals program and a potential payout under the annual PBP plan early next year.

Looking ahead, we expect continued sequential unit cost improvement with an increase in Q2 of 15% to 17% versus 2019. As I just mentioned, our cost forecast includes an assumption that employees will continue to earn a payout under the performance-based pay program, and it also includes the 3-point headwind specific to Seattle's airport costs. We expect this sequential improvement versus 2019 to continue throughout the year as more capacity comes back and as we make gains towards the structural cost initiatives we've outlined in previous calls. We do expect to return to pre-COVID unit costs or better at some point in the next several quarters.

Lastly, on guidance, I expect Q2 GAAP operating cash flow will be approximately $450 million to $550 million, which reflects an improvement of $200 million to $300 million versus Q1, solely associated with the recovery of the business. This guidance is inclusive of the grant portion of the third CARES Act PSP program.

To close, we are proud of the work our Alaska and Horizon teams did this past year to manage through the worst depths of the pandemic-induced crisis. And we are now hopeful that we can completely focus from here forward on rebuilding our network and our margin profile, then growing and returning to balanced capital allocation. We are fortunate to be well positioned coming into the initial part of recovery. We have a strong balance sheet that should continue to improve throughout the year. We have a competitive advantage in our cost structure that we will continue to work to improve over this year and next, and we are on the path to get all of our folks back ready to welcome guests as they get flying again.

With that, let's turn to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Andrew Didora with Bank of America.

Andrew George Didora - *BofA Securities, Research Division - Director*

First question for Andrew. Just wanted to touch on Hawaii. It's clearly a market, it's opening. It's all leisure. What percentage of your ASMs will be here in 2021? And do you think it will have better or worse or the same margins relative to the system as compared to pre pandemic?

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Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Andrew, I'm not going to comment on margins, but Hawaii, for the next little bit here, is about 15% of our capacity. And what we have seen is that -- and the same with Mexico a little bit, is that the testing and all the requirements they have seem to be working fairly smoothly. So demand in Hawaii is solid.

Andrew George Didora - *BofA Securities, Research Division - Director*

And how is the competitive response on those Hawaii routes?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

I'm not -- as far as competitive response, specifically, what are you referring to?

Andrew George Didora - *BofA Securities, Research Division - Director*

The competitive capacity.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Oh, I see. Well, what I can tell you is that from where we sit in our loyalty, we've been very good. We think, by this summer, we will be up to our pre-pandemic frequencies of about 32 a day. And given where we focus our flying, we feel very good about the seats, and it's performing well.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Hey, Andrew, this is Ben. I think we have the perfect product for Hawaii to compete. We've got a strong first-class product. We have a premium product that people love and a generous main cabin with great service, and we're starting to bring our product back. So we have the perfect product to compete on our Hawaii routes.

Andrew George Didora - *BofA Securities, Research Division - Director*

Okay. And just secondly for Shane. I know in the past, Alaska has hedged fuel a little bit more from using call options as insurance. Do you have any hedges on right now? And are there any internal discussions on maybe stepping that back up today given where fuel has gone?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Andrew, good to talk to you. Yes, we actually never did anything different with our hedging program throughout the pandemic so we were overhedged last year, obviously, as capacity came way down, and we had already put a lot of positions on for last year.

I think, right now, we're back to our normal cadence about 18 months in advance of a quarter, we start layering on hedges up to about 50% of expected consumption, 20% out of the money. That's what we've done for the past several years.

Strangely enough, we did ask ourselves, should we change our program or do something differently just in the past several weeks and all of the data that we looked at suggests that we really like our program how it is, and we don't plan to change it from here forward.

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Operator

The next question will come from Myles Walton with UBS.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

I was hoping you could just touch on the California reopening. And I know it's only going to capture a little bit of the June quarter, but as you look to the bookings trends to July and August, are you seeing the population move in advance with that? Are they kind of sitting on their hands waiting for final confirmation? And moreover, what does it imply just early reads about what you're going to do with the network into 3Q?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. Thanks, Myles. I think California is slowly coming back. We're obviously seeing an improvement in bookings, but we feel pretty good about the way we've structured our network. About 1/5 of our ASMs in the second quarter will be in California, and we're still going to be down 50% in capacity, so we have plenty of room on the airplanes. And I think we're just seeing increasing trends, but it will -- come June will be the real tell tale about how big that step change is.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

And one quick -- and maybe one quick one was on loyalty. You mentioned that oneworld, you're going to lay out an economic framework or contribution framework at a future date, but given you planted a seed, I'll ask you to water it a little. Can you comment on how much of that economic contribution framework will be indirectly or directly through the loyalty versus through the network?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. We're going to comment on that at a little later date. Obviously, international travel is basically next to nothing. But we both got domestic and international. And I think, overall, certainly, on the loyalty side, you're going to be -- that's a very, very strong area for us. Corporate business, another very strong area for us. And then, of course, the incremental network passengers from international and, of course, just our joint domestic partnership with American as well. So good things there.

Operator

The next question will come from Savi Syth with Raymond James.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

Prior to the crisis, you were working on getting pretax margins to 13% to 15%. And I wonder if you could provide an update on your kind of ability to get there eventually, and especially if business demand doesn't kind of fully recover to pre-crisis levels in 2022 or 2023?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Thanks, Savi. These are fun questions to get to talk about future profit margins that reflect the sort of pre-COVID level. We have -- Ben mentioned in the script to road map back to profitability. And as you know, a long time ago, we set 10% as a minimum threshold, and we've talked a lot about 13% to 15% as a normal sort of level that we think is appropriate in the industry. To the degree that the economic backdrop sort of helps support those levels, we certainly expect to be one of the top margin players in the industry, and we do want to get back into that range.

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I think it's a little early to talk about like when that could happen and if it's clearly going to happen. I keep thinking we'd like to get through this sort of initial pent-up demand surge and into the back half of the year to see where business travel kind of shapes up to your point. And then I think we'll have a better picture of ultimately where margins may shake out, but we're not abandoning that goal at all. We think, long term, it's a place the industry, could, can and should be and we should be amongst the leaders from a margin perspective.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

That's helpful, Shane. And maybe if I can follow up just a little bit on your comment about kind of getting back to that -- getting to like a $2 billion to $2.5 billion liquidity target. Just wondering what the logic behind kind of that level versus something else?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Yes. No, it's -- look, it's a little bit judgment and instinct. And if there was another unexpected big step back, we don't want to be scrambling. So we've been talking a lot about this. If cash flow generation continues to improve into Q3 and Q4, advance bookings look good, some business travel comes back, we could see ourselves going on the lower end of that. I think what we've committed to internally right now is no lower than $2 billion coming out of this year. We have a big capital commitment next year, and so we want to be mindful of that as well, Savi, but we're well above our normal sort of need for cash right now.

I don't know if we'll ultimately go back to $1.2 to $1.5, that's something that I think we'll be sort of thinking about and making decisions about the next 6 months or so.

Operator

The next question will come from Joseph DeNardi with Stifel.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Andrew, how effective is Alaska at monetizing customers outside of the airplane? You all obviously are pretty effective with Bank of America. I'm curious what you think the opportunity is beyond the co-brand partnership?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes, you're talking about really merchandising and upselling that type of thing you're referring to?

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Sure. Other partnerships, just finding other ways to use data to kind of market your loyalty customers outside of the credit card.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. We've been doing a lot of work on the digital side on as.com. We've become experts in promotions over the last 6 months, and the teams are getting very sophisticated on how we go about doing that, in the programs we do that.

We also have other things like premium class is going to become a cabin, just like first class, and we see opportunity there. Our first-class product now is what we call J class, which historically it was F, so I think corporate customers are going to have greater access.

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And I think we're working on a number of things, and as shared in the script, we'll lay more of this out as we move deeper into the year. But we have a lot of revenue upside benefits outside the core coupon ticket that we're working on.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Okay. And then, Ben, you mentioned one of the strategic priorities is maximizing the value of the brand. I think is what you said that piqued my interest shockingly, so what did you mean by that?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Yes. No, I appreciate it, Joe. Look, I'm a big believer in Alaska. And if you look at the strength we have in the Pacific Northwest and the state of Alaska, and the loyalty and love for our brand, I just think there's huge potential in unlocking this brand more than we have in California and across the country. So this brand is powerful when people get to know it, when people fly us, they love us. They love our people who do just a wonderful job every day, and so I just think there's a lot this brand can offer once people get to know it more.

Operator

The next question is from Duane Pfennigwerth with Evercore ISI.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Shane, you talked about some accruals, I think, for hitting your operations target as well as maybe some profit share. What are the circumstances under which you would be paying for profit sharing early next year?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Hey, Duane, good to hear from you. Yes. So our PBP plan always has multiple components. Profit is the typically largest component under that program, and we don't expect, honestly, to pay out under that particular metric. We didn't change the threshold target or max, so we would have to hit a full year pretax margin of 5% to pay out for profits. But we also have operating cash flow goals in the program this year. We've got carbon reduction goals. We've got cost-related goals around productivity and safety goals. And the company is -- folks are doing a really good job against each one of those right now, so those are the potential areas, I think, that we see a potential payout.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

That's great. I wanted to make sure I wasn't reading too far into it. And then maybe just across the network, is there anything you're seeing on a revenue basis that's up at this point relative to 2019? And I wondered if you talk about bookings into state of Alaska.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. Thanks, Duane. It's -- the network, obviously, is stronger in some areas than others. We're not at prior pre-pandemic load factors. We have a couple of regions now that are into the 80%. But of course, the fares and the yields are not where they were back in 2019. So overall, across our network, revenues are building. State of Alaska, there's obviously incremental capacity coming in this summer, but we feel really good about our network for this summer. And we love our brand, and we've been marketing it well, so we see Alaska being a good story this summer for us.

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Operator

The next question will come from Helane Becker with Cowen.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So 2 questions. Ben, I'm wondering if you could tell us how you're going to measure the carbon goals for your profit sharing? How should we track that? Or how are -- actually, more importantly, how are you tracking that?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

So -- and I'll let Diana jump in, in a second. So it's really important on the climate, Helane, that we have 2 short-term goal or we have 2 goals. One is the long-term goal net 2040, where carbon emissions we're targeting to be 0. I'll let Diana speak to that in a second. And then the short-term goal, which is being the most fuel-efficient airline in the next 5 years, which is what Shane was referring to, we've tied our performance-based pay program, where we're going to measure carbon impact per ASM. So that's how we're going to measure that short-term goal. And every employee in the company is going to be measured on that, that will be 10% of the payout for our PBP.

But Diana, could you share a little more on the 2040 and how we're going to do that?

Diana Birkett Rakow - *Alaska Air Group, Inc. - VP of External Relations*

Sure. I think Helane was asking -- just to clarify, Helane, you were just asking about the PBP goal in the -- in our employee base pay plan, which is, as Ben said, pounds of CO_2 per ASM.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Right. Exactly. Like I was just trying to figure out how you're going to measure that. So that's the answer, right? Pounds of CO_2 per ASM. And the goal is to lower it.

Diana Birkett Rakow - *Alaska Air Group, Inc. - VP of External Relations*

Got it. Yes. And it's based on fuel use. So we set a target based on our -- looking at our budgeted ASMs and our budgeted fuel use, and we are aiming to reduce carbon emissions from year-over-year from what we would predict, would be flat.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Okay. That's very helpful. And then my other question is I'm wondering if, completely unrelated to environment, can -- Andrew, could you do like a bridge to how you're thinking about raising yields? I know it's, in part, based on demand, but how are you -- given the lag between bookings and pricing, how should we think about fares trending this summer? And a bridge from maybe where you are to where you want to be, which would be, say, pre-pandemic levels?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Sure. Yes. Well, a couple of things on yield that are facts, Helane, as you know, you can push yield up with more volumes of business travel, and to date, that's really significantly down. And you can push yield up when flights get fuller. And so you're exactly right. We've built our base with bookings that were during really low booking periods and stimulation and getting a good base. So what we're seeing right now is that as we move forward into the second quarter and certainly into the third quarter, we're bringing in new traffic, and you've heard others comment, and it's the

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same for us too - that the yield and average fares coming in, in summer right now for our peak flights are actually higher than 2019. So I think you're going to see a sure but stable climb, but I will say that a lot of this is dependent on business traffic.

And of course, capacity. We all know what everyone is flying in May. We sort of see June. But beyond that, we haven't seen proper schedules load, and that will also dictate on what happens with yields.

Operator

The next question will come from Jamie Baker with JPMorgan.

Jamie Nathaniel Baker - *JPMorgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Can you be a little bit more specific as to the milestones you need to achieve before you begin returning capital to shareholders? Obviously, acknowledging the PSP restrictions that are in place. Just wondering what internal metrics or milestones you're looking for?

Nathaniel Pieper - *Alaska Airlines, Inc. - SVP of Fleet, Finance and Alliances*

Hey, Jamie, it's Nat Pieper. As you know, taking care of our shareholders has always been a core priority for us as we run our business, and I have to take the opportunity to remind you that we're proud we didn't issue equity or dilute our shareholders to raise funds through the pandemic. And we want to restart shareholder returns as soon as it makes sense.

Like most things here, we have a checklist to complete before doing so. And these items won't be a surprise for you, balance sheet strength, getting debt-to-cap back in its target levels, positive cash flow and sustained profitability. So really, once Ben and our Board gives us an A on the checklist, I'd anticipate reengagement in that area.

You're right that we've got government restrictions as well on both buybacks and dividends until September of 2022 due to the PSP triumvirate, and we'll balance that, too.

Jamie Nathaniel Baker - *JPMorgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Okay. That's helpful. I appreciate it. And second, your comments earlier about first-class yield momentum, I found that interesting. The transcon premium market continues to improve from a passenger perspective. You've got Delta 764s now that are flying with the, what I call, sort of the pseudo-suite product, Mint is getting a refresh. Is there anything happening in the premium transcon market that might make you revisit your decision to exit? Or are you still happier than ever with that decision?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

So I think, Jamie, you're referring to maybe lie-flat seats. Here's what I'll tell you about -- on the first-class cabin, we're -- our product is made for the conditions that we have today. We have 12 and 16 seats, very -- the largest pitch for non-lie flat seats in the industry. And we've been really focusing on selling demand into those seats. And Ben mentioned before, Hawaii has been a very strong point for us.

On the transcon right now, even if you look into sort of May, our capacity was down 70% because the demand is not there right now. So we're seeing first-class perform on our Hawaii flights, on our north-south flights and that sort of thing. So it's just been the perfect product and people are willing to buy up right now with good low fare. So it's a good news story.

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Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

And Jamie, this is Shane, I'll just -- on the actual like, no, we're totally happy with our decision to not have moved into that market. It makes sense for certain carriers to do it. It didn't make sense for us. We'd have to sell 3/4s of those at $1,000 or better. It's just not the model we have, and we don't really like selling $1,000 fares anyway. We'd like to make a lot of money selling lower fares, so we're feeling very good about our decision.

Operator

The next question will come from Catherine O'Brien with Goldman Sachs.

Catherine Maureen O'Brien - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I think my first one is probably for Shane. On your CapEx outlook, I just wanted to confirm that $150 million to $200 million is gross CapEx and that's not net of any financing on aircraft from Alaska's order book? And then based on the deposits Boeing already has from Alaska, and I'm guessing some negotiations around purchase price, given the MAX grounding and your new order. When do you work through those deposits? And what will CapEx look like over the next couple of years?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Yes. Thanks, Catie. And I'm going to have Nat help out on this, but I'll answer the really hard one first. Yes, it's gross CapEx. It's not net. And I'll give the easy one to Nat.

Nathaniel Pieper - *Alaska Airlines, Inc. - SVP of Fleet, Finance and Alliances*

Awesome, delegation. I think in this year, with that PDP balance and Catie, as we talked about in previous quarter when we made that order, all of our 2021 obligations related to it are taken care of. So very little, if any, cash out for our 2021 airplanes.

In 2022, we've been public with a CapEx number of $1.3 billion, $1.4 billion, and that's 31 airplanes coming in 2022. We have, as part of our negotiation with Boeing, restructured our PDP pool a bit, and so we'll be using that leverage appropriately as well, so we're comfortable with where that sits.

And we're also comfortable, even though that is a big requirement in 2022, we can achieve that and still get our balance sheet strength back to the levels that we want to retain.

Catherine Maureen O'Brien - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. And then maybe one for Andrew. It sounds like there's definitely more to come on this, but a question on American and oneworld partnerships, just like a higher level theoretical question. As international and corporate ultimately start to recover and you potentially see your corporate share improve, coupled with some of the new RM changes you also spoke about, should we expect Alaska to just be a higher yield carrier ultimately post COVID versus pre-COVID? Kind of assuming maybe all else equal on the leisure side of the business just for ease of this question.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. Thanks, Catie. My view is absolutely yes. Given the things that have been put in place that give us access on the corporate side, I do believe that our share will grow even, as I shared, already seeing it even in the low numbers in that first part of this year that we'll attract higher-yielding traffic as business demand returns.

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Operator

Your next question will come from Hunter Keay with Wolfe Research.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Passenger Airlines, Aerospace & Defense*

So Ben, last June, you made a prediction that '21 -- 2021 revenue would be down 20% to 35%, which was actually an amazingly pretty good guess, where we stand here today. I don't know how you did -- how you knew that, man, but given your track record, as you look at '22, do you think it will be up relative to '19?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

What I'll say it's all that ops background, Hunter, that helps me with the financials. No. You know what, Hunter, the way we've looked at stuff is we try and be realistic with what we see. So as we look at this fall, it's hard to see what's exactly going to happen, but we can make some solid predictions. We know leisure demand is coming back for us pretty much at 100%. We're at 25% of business right now. We probably will see a step change in business demand by the end of the year as the vaccines rollout and businesses relax their restrictions. So that should double. It should be 50% is what we're predicting for business demand by the end of the year, and so we should see it much higher than the first and second quarter. So we should be getting close to where we are in 2022.

I'm not going to give you a number, but we feel good about 2022, and we're trying to set up ourselves in 2021 just to solidify that road back to profitability, get all this transition training done so that we can fire on all cylinders in '22.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Passenger Airlines, Aerospace & Defense*

Okay. And then Shane, just to follow up on Jamie's question a little bit, you talked about balanced capital allocation. How do you think that term is going to change from pre COVID to post COVID? Is it -- back to paying some nominal dividend? Is it maybe, hey, this makes more sense to think about like investing in the products a little bit more post COVID? Or doubling down on the repo, I don't know however it might be or just paying down debt, like how does the term balanced capital allocation change in 2 years relative to what it was in 2018, 2019?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

These are -- we always love your questions. You guys usually prompt us to go back and think about things a little bit more. This isn't something that -- this is a little bit off the cuff, so I want you to know that. I don't -- I'm guessing it's going to be a tweak more than an overhaul. And our basic approach historically has been, get the balance sheet to our target range and then make sure we're growing at an appropriate rate, 4% to 8% annually. And then fund pensions robustly and then make sure we're returning to shareholders. And we sort of like to set up where we had a dividend and then we topped off with share repos. And I think that's our default as we go forward.

I know it's not like, sexy or something because it's not exotic or new. I do get the question, though, that there are certain areas of the business that coming out of COVID, we'll see if the market and expectations change from a customer perspective. Certainly, things around cleanliness and sort of feeling of safety, we're making investments in, although those are things that we've been doing this past year, and they'll just stick with us, and I don't really view that necessarily as capital allocation. But I think it's -- it'll -- our mindset is mostly returning to kind of where we were before, and we'll adjust as we learn things going forward. Anyhow, yes, that's kind of where my head is at on that right now.

Operator

The next question will come from Mike Linenberg with Deutsche Bank.

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Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

I guess just 2 here. One, Shane, where are we on the secured loan with the CARES Act? The second one, I may have missed it, but I know you had drawn down a piece and there was like another $1.7 billion, I think. What's the status on that? Is that still out there?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

You've got it right, Mike. I don't know how you guys keep all this stuff straight because sometimes we have to -- we struggle to. But yes, we had to take a portion of that loan down by law initially, about $135 million, that remains outstanding. And then we have access to another $1.7 billion through May. I don't see really any scenario where we'll tap or access that $1.7 billion. But we have until May so we haven't formally made a decision on that quite yet.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Which then leads to -- me to ask that I think the plan was that loyalty would feature into something along those lines. And if you don't tap it, are you still considering loyalty? Or maybe I can answer the question, it sounds like you're done with everything on the financing side, is that right?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

You got it.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Great. Great. And then just my second question to Andrew. Andrew, you gave us a little sliver of information on your improvement in corporate share. And I realize the March quarter of 2021 is probably not all that representative of a normal quarter because of COVID, but the fact is, the American agreement, I believe, has now been in place, I think, for almost a year. Maybe it has been a year. Can you just give us maybe some other quick wins? Like in the past, you talked about whether a number of passengers connecting on a daily basis or in the past, we've heard airlines say, 3 to 4, 5 load factor points are attributable to the code share agreement, et cetera. Anything else that maybe you saw in the earlier part of the agreement, although again, I do realize it came into place in COVID?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. I think more to come on that, Mike. I think just the networks and the demand and everything. But here's what I will say is that from a joint contracting perspective, there's been overwhelming engagement of corporate contracts wanting to jointly contract with us and American given the joint utility and opportunity we give them. We've seen very positive and strong guest feedback from our guests around getting back American and their ability to accrue and redeem miles. We have full access back behind from the Pacific Northwest through Mid connecting hubs in the U.S. and even California through Chicago. So there's a lot of good things. But to your point, until demand and the water starts flowing through the pipes, we won't see the true benefit, but we're ready for it when it comes.

Operator

The next question will come from Dan McKenzie with Seaport Global.

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Daniel J. McKenzie - *Seaport Global Securities LLC, Research Division - Research Analyst*

I guess, just a question on the balance sheet targets, just following up on some of the prior questions. I'm wondering what the time frame is in the back of your mind to get to that target? And I guess, I'm just trying to reconcile the step-up in CapEx next year with where you want the balance sheet to be ultimately?

Nathaniel Pieper - *Alaska Airlines, Inc. - SVP of Fleet, Finance and Alliances*

Dan, it's Nat. I think as we move over the next 12 to 15 months, and obviously, there's revenue and positive cash flow coming in as part of that, and assumptions we're making, as we see it. But I see us by the latter stages of '22 being in the region that we want to be from a debt-to-cap perspective, and that's inclusive of the CapEx requirements we've discussed for '22.

Daniel J. McKenzie - *Seaport Global Securities LLC, Research Division - Research Analyst*

Got it. Okay. And then as we move past 2022, you've got the step-up in CapEx, how should we think about what a normalized CapEx would look for you guys in the context of a 4% to 8% growth?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of Finance*

Hey, Dan, that's a great question. We -- let us come back to you on that. I just want to -- as we're in the middle of a fleet transition, I just want to make sure we've got really, really good data on how many planes are going out and coming in, in '23 and '24 as we shift the schedule around. But I think we basically need to replace 60 aircraft over the next couple of years, and then we need to add about 10 to 12 units a year relative to our pre-COVID mainline fleet size, which was 235 in order to kind of maintain that range. So I'm just -- I sort of know all the math, but I want to make sure we get you a tight answer on it. It's a good question.

Operator

And at this time, there are no further questions. I would like to turn the conference over to Ben Minicucci for any closing comments.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Thank you, everyone, for joining us. If you have any other questions, please reach out to our IR folks. Have a great day, and we'll talk to you next quarter.

Operator

Thank you for participating in today's conference call. This call will be available for future playback at alaskaair.com. Ladies and gentlemen, you may now disconnect.

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